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IN THE SUPREME COURT OF
THE UNITED STATES

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October Term, 1989

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TEXARKANA NATIONAL BANK
Petitioner

vs.

THE FEDERAL DEPOSIT INSURANCE CORPORATION,
in its corporate capacity as liquidator of
Guaranty Bond State Bank
Respondent

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# PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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James N. Haltom
(Counsel of Record)
Randall D. Goodwin
HUBBARD, PATTON, PEEK,
HALTOM & ROBERTS
Post Office Box 1928
Texarkana, TX 75504
(214) 794-3341

140 pp

## QUESTIONS PRESENTED

I. When a bank president places on the books of the bank certain fictitious loans and fraudulently induces a correspondent bank, which:

1. does not know of the fraud;

2. is not negligent in failing to discover the fraud; and

3. is innocent of any wrongdoing,

to purchase participations in those fictitious loans, and the correspondent bank exercises its right to set off those fraudulent loan participations against the now insolvent bank and FDIC as Receiver, will the doctrine expressed in *D' Oench, Duhme & Co. v. FDIC*, 315 U.S. 447, 62 S.Ct. 676, 86 L.Ed. 956

(1942) bar the correspondent bank's assertion of an affirmative defense based on the setoff in a subsequent action brought by FDIC in its corporate capacity?

II. When a bank has exercised its right to set off fraudulent loan participations against an insolvent bank and FDIC as Receiver, will 12 U.S.C. § 1823(e) bar the bank's assertion of the setoff as an affirmative defense in a subsequent action brought by FDIC in its corporate capacity to enforce certain obligations which were subject to the setoff?

## INTERESTED PARTIES

The following listed persons have an interest in the outcome of this case.

1. The Federal Deposit Insurance Corporation ("FDIC"), in its corporate capacity as liquidator of Guaranty Bond State Bank - Respondent.

2. The Texarkana National Bank- Petitioner.

3. Texarkana National Bancshares, Inc. - Parent Company of The Texarkana National Bank.

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PETITION FOR A WRIT OF CERTIORARI
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## OPINIONS BELOW

The Fifth Circuit Court of Appeals in its opinion (reproduced as Appendix A-1), dated June 2, 1989, and reported at 874 F. 2d 264, reversed that part of the judgment of the United States District Court for the Eastern District

of Texas, Texarkana Division (reproduced as Appendix B-2), dated February 8, 1988, wherein the district court rendered a take nothing judgment against FDIC in its causes of action against The Texarkana National Bank ("TNB"), and affirmed, as modified, the judgment of the District Court rendering judgment for TNB in its cause of action against FDIC.

The district court based its judgment on a Memorandum Opinion with Findings of Fact and Conclusions of Law (reproduced as Appendix B-1) dated February 8, 1988. In its Memorandum Opinion, the district court concluded that TNB had established, *inter alia*, its right to rescind certain fraudulent loan participations against FDIC and that it had established its right to set off these fraudulent loan participations against debts owing Guaranty Bond State

Bank ("GBSB") by TNB. The Fifth *Circuit, while not challenging the* Findings of Fact and Conclusions of Law of the district court in this regard, nevertheless surprisingly reversed this part of the district court's judgment on the ground that *D' Oench, Duhme & Co. v. FDIC,* 315 U.S. 447, 62 S.Ct. 676, 86 L.Ed. 956 (1942) as codified in 12 U.S.C. § 1823(e), barred TNB from asserting a setoff based on the fraudulent loan participations since "TNB failed to get the representations (of GBSB's officers) in writing".

TNB, through a Petition for Rehearing dated July 5, 1989, brought to the attention of the Fifth Circuit its error in applying 12 U.S.C. § 1823(e) when FDIC in its corporate capacity had acquired no right, title or interest in the property which is the subject matter of this suit, in applying *D' Oench, Duhme*

and § 1823(e) to bar TNB's assertion of setoff when TNB was totally innocent and not negligent in its dealings with the failed bank and when its application will not further the policies underlying *D'Oench, Duhme,* and its factual error in holding that TNB failed to get the misrepresentations of the president of GBSB in writing. However, the Fifth Circuit on July 19, 1989, entered an Order (reproduced as Exhibit A-2) denying TNB's Petition for a Rehearing.

## GROUNDS FOR JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1). Petitioner seeks a writ of certiorari to review the decision of the Fifth Circuit dated June 2, 1989, the petition for rehearing of which was denied by an order dated July 19, 1989.

## STATUTE INVOLVED

12 U.S.C. § 1823(e) states:

> No agreement which tends to diminish or defeat the right, title or interest of the Corporation in any asset acquired by it under this section, either as security for a loan or by purchase, shall be valid against the Corporation unless such agreement (1) shall be in writing, (2) shall have been executed by the bank and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the bank, (3) shall have been approved by the board of directors of the bank or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) shall have been, continuously, from the time of its execution, an official record of the bank.

## STATEMENT OF THE CASE

This action arose out of the closure and receivership of GBSB. The FDIC in its corporate capacity ("FDIC-Corporate") brought a breach of contract action against TNB seeking amounts allegedly due to GBSB under two certificates of deposit, three loan participation agreements, and an

automatic teller machine ("ATM") agreement. TNB asserted as an affirmative defense that it had properly set off these liabilities against amounts due to TNB under thirteen valid loan participation agreements, two loan participation agreements whose underlying loans were fictitious ("the Bell and Gunther loan participations"), and ten subordinated capital debentures of GBSB. TNB also counterclaimed for additional fees arising under the ATM agreement and for amounts due under an additional loan participation agreement. The district court found in favor of TNB on all counts.[1] The Fifth Circuit reversed the district court's approval of TNB's setoff to the extent of the amounts owed

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[1] FDIC did not appeal from the judgment of the district court to the extent that it approved TNB's setoff of the amounts owed on the 13 valid loan participations.

on the Bell and Gunther loan participations and the subordinated capital debentures. The Fifth Circuit affirmed the district court's judgment in favor of TNB on its counterclaim for additional fees arising under the ATM agreement and modified the district court's judgment in favor of TNB on its counterclaim for amounts owed under the additional loan participation agreement.[2]

Statement of Facts

Prior to July 28, 1982, GBSB was a banking institution located in Redwater,

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[2] TNB will not dispute that portion of the Fifth Circuit opinion reversing TNB's setoff insofar as it relates to those amounts represented by the subordinated capital debentures. Further, TNB does not dispute the Fifth Circuit opinion insofar as it modifies the amounts awarded to TNB on its counterclaim. This Petition concerns only that portion of the Fifth Circuit opinion reversing TNB's setoff insofar as it relates to those amounts represented by the Bell and Gunther loan participations.

Texas, organized and existing under the laws of the State of Texas. TNB is a national banking institution located in the nearby city of Texarkana, Texas. In the normal course of its banking business, TNB has for many years entered into loan participation agreements with other banks. Pursuant to these agreements, TNB purchases varying interests in loans originated by the other banks. Also, from time to time, TNB sells to other banks varying interests in loans in which TNB is the originating bank. The vehicle by which banks purchase interests in loans originated by other banks is called a loan participation agreement. This is a common practice among banks, and both TNB and GBSB participated in each other's loans as well as those of other banks, for instance, banks in Little Rock, Arkansas and Dallas, Texas. (Tr.

193-194).[3]

Between November 24, 1981, and July 21, 1982, TNB, in its normal course of business, purchased thirteen participations in various loans originated by GBSB in the aggregate amount of $317,120.23 ("the thirteen valid loan participations"). (Pl. Ex. 18-29 inclusive, and 32). All of these loan participations were valid and the underlying loans were eventually paid by the makers according to their terms. (Tr. 83).

Sometime during the first seven months of 1982, GBSB's president, Henry Earl Fagan, created numerous fictitious

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[3] The Record as certified to the Fifth Circuit will be cited as "R. __". The Trial Transcript, which constitutes Volumes IV and V of the Record, will be cited as "Tr. __". The Plaintiff's (FDIC) Exhibits admitted at trial will be cited as "Pl. Ex. __". The district court's Memorandum Opinion with Findings of Fact and Conclusions of Law will be cited as "Mem. Op. __".

promissory notes pursuant to a scheme to defraud GBSB of over $4 million. Among the fictitious notes created by Mr. Fagan were a note in the principal amount of $127,500.00 purportedly executed by Adam D. Bell, and a note in the principal amount of $120,000.00 purportedly executed by Cecil H. Gunther.[4] (Pl. Ex. 30 and 31). On or about June 30, 1982, GBSB's president offered TNB the opportunity to participate in the loans purportedly made to Bell and Gunther. In order to document these purported loans, Mr. Fagan presented TNB with the following written documents:

> 1. A Promissory Note dated June 26, 1982, in the face amount of $127,500.00, payable to GBSB, bearing the purported signature of Adam D. Bell, and

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[4] FDIC's principal witness at trial admitted that these loans were bogus and that he knew Mr. Fagan was currently in prison as a result of this fraud. (Tr. 86, 89).

witnessed by "J.G." for GBSB (Pl. Ex. 30);

2. A Collateral Inspection Certificate signed by H. E. Fagan, GBSB's president, as inspector, purporting to report the number and condition of certain livestock owned by Adam D. Bell (Pl. Ex. 30);

3. A Financing Statement signed by H. E. Fagan, GBSB's president, and bearing the purported signature of Adam D. Bell (Pl. Ex. 30);

4. A Promissory Note dated June 4, 1982, in the face amount of $120,000.00, payable to GBSB, bearing the purported signature of Cecil H. Gunther, and witnessed by Tish Grimes for GBSB (Pl. Ex. 31);

5. A Collateral Inspection Certificate signed by H. E. Fagan, GBSB's president, as inspector, purportedly reporting the condition and number of certain livestock owned by Cecil H. Gunther (Pl. Ex. 31); and,

6. A Financing Statement signed by Jean Green, Assistant Cashier of GBSB, and bearing the purported signature of Cecil H. Gunther (Pl. Ex. 31). (Tr.

170-175, 193).[5]

Based upon the purported genuineness of these documents as represented by the signatures of GBSB's president and other officers on those documents, TNB purchased the Bell and Gunther loan participations to the extent of $100,000.00 each. At this time, TNB had no knowledge of Mr. Fagan's fraudulent scheme nor of the fictitious nature of the Bell and Gunther loans, and had never before had the occasion to believe that Mr. Fagan had sought to sell a participation in a non-existent loan. (Tr. 194). In fact, there was nothing about these purported loans and their supporting documentation which distinguished them from the thirteen

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[5] Although all of these written documents were introduced into evidence by FDIC, the Fifth Circuit ignored them in its erroneous conclusion that TNB failed to get the representations of GBSB's officers "in writing".

valid loan participations which were purchased from GBSB during the same time period.

Less than four weeks after TNB purchased the Bell and Gunther loan participations, GBSB was declared insolvent and ordered closed by the Banking Commissioner of Texas. On July 28, 1982, FDIC was appointed Receiver of GBSB. On July 29, 1982, FDIC, as Receiver, ("FDIC-Receiver"), entered into a Purchase and Assumption Agreement with First State Bank and Trust, Redwater, transferring certain acceptable assets and liabilities of GBSB to First State Bank and Trust, Redwater. (Pl. Ex. 1). (Tr. 30). On that same day, FDIC-Receiver sold the remaining assets of GBSB to FDIC-Corporate, leaving essentially no assets in the receivership. (Pl. Ex. 1 and 2). (Tr. 31).

On or about August 2, 1982, two officers of TNB, Guy Dickert and Keith Chambers, sought the advice of FDIC's field-liquidator-in-charge, James Duval, as to the proper procedure to be used in resolving the mutual obligations and transactions of TNB and GBSB (Tr. 180). During the conversation, Mr. Duval suggested that a setoff might be appropriate. (Tr. 181, 214-215). Acting upon this suggestion, TNB set off assets of GBSB in the possession of TNB totalling $495,873.12, against certain liabilities owing to TNB from GBSB in the same amount. The assets of GBSB set off by TNB were as follows:

> 1. Two Certificates of Deposit ("the CDs") in the amount of $100,000.00 each, with interest accrued through July 27, 1982. (Pl. Ex. 9); and,
>
> 2. The principal balance remaining on three loan participations in which TNB was the originating bank and GBSB was the participating bank ("the TNB participations"), together

with interest accrued through July 27, 1982. (Pl. Ex. 9).

TNB set off the following liabilities of GBSB owing to TNB:

1. The principal balance of the Bell and Gunther loan participations, in the aggregate amount of $200,000.00, together with interest through July 27, 1982. (Pl. Ex. 9). (Mem. Op. Findings 29-40, inclusive). (R. 700-702).

2. Ten GBSB capital debentures in the aggregate amount of $100,000.00, together with interest through July 27, 1982. (Pl. Ex. 9). (Mem. Op. Findings 43-44). (R. 702).

3. The principal balance, together with interest through July 27, 1982, of the thirteen valid loan participations purchased by TNB from GBSB, aggregating $192,479.78. (Pl. Ex. 9). (Mem. Op. Findings 16-28, inclusive, and 58). (R. 699-700, 704).

Acting upon Mr. Duval's suggestion, TNB notified Nicholas J. Flores, FDIC's field-liquidator-in-charge at GBSB, that it was exercising its right to set off certain assets of GBSB in the possession of TNB against certain liabilities owing

TNB by GBSB. (Pl. Ex. 9). The effective date of the setoff was July 27, 1982.

Opinion of the District Court

Based on the evidence presented at trial, the district court included among its Findings of Fact and Conclusions of Law that TNB had purchased from GBSB, for $100,000.00 each, participations in the purported loans to Adam D. Bell and Cecil H. Gunther. (Mem. Op. Findings 29, 35). (R. 700-701). The court also found that the president of GBSB represented to TNB: 1) that the loans had been made to Adam D. Bell and Cecil H. Gunther, 2) that the signatures on the loan documents, security agreements and supporting documents were the signatures of Bell and Gunther, and 3) that the president or other officer of GBSB had personally inspected the purported collateral of Bell and

Gunther. In fact, these loans were never made by GBSB to Bell and Gunther and the representations of GBSB's president were misrepresentations of material facts made with the intention to induce TNB to purchase the Bell and Gunther loan participations and which were relied upon by TNB in its purchase of these participations. (Mem. Op. Findings, 30-24, 37-40). (R. 701-702). The court found that on August 3, 1982, effective July 27, 1982, TNB carried out an internal offset of the CDs and the TNB participations which are the subject matter of this suit, against certain liabilities of GBSB, including the Bell and Gunther loan participations. (Mem. Op. Findings 53). (R. 703-704).

In accordance with the evidence, its Findings of Fact, and existing legal and equitable principles and authority, the trial court concluded that the

president of GBSB had made material and fraudulent misrepresentations which were intended to and did induce TNB into purchasing the fraudulent Bell and Gunther loan participations, and that TNB's reliance on such misrepresentations was justified. As a result, TNB was entitled to a rescission of the Bell and Gunther loan participations, based on fraud, prior to GBSB's insolvency and FDIC's liability on this claim was absolute and certain in amount when suit was filed. (Mem. Op. Conclusion I). (R. 706-707). Further, the court concluded that TNB had a provable claim against FDIC in the amount of its participation in the fraudulent Bell and Gunther loan participations, that TNB had a right of setoff and had exercised its setoff in a timely manner. Therefore, the court concluded, the setoff was valid and

proper and not a preference in violation of 12 U.S.C. § 94. (Mem. Op. Conclusion II, V). (R. 707-708).

### Opinion of the Fifth Circuit Court of Appeals

The Fifth Circuit reversed and remanded. The Court of Appeals' opinion was not based upon any disagreement with the Findings of Fact of the trial court in regard to the fraudulent Bell and Gunther loan participations. Rather, the Fifth Circuit simply held that:

> TNB failed to get the representations (of GBSB's officers) in writing. Therefore, *D'Oench, Duhme* as codified in § 1823(e), bars TNB from asserting a setoff based on those representations.

*Federal Deposit Ins. Corp. v. Texarkana Nat. Bank*, 874 F.2d 264, 268 (5th Cir. 1989).

Petitioner's Motion for Rehearing, arguing that the Fifth Circuit had erred in applying § 1823(e) when FDIC-Corporate had acquired no right, title

or interest in the property which is the subject matter of the suit, that it had erred in applying *D' Oench, Duhme* and § 1823(e) in barring TNB's claim when TNB was totally innocent and not negligent in its dealings with the failed bank, and that the court erred in its factual holding that TNB had failed to get the misrepresentations of the president of GBSB in writing, was denied by the Fifth Circuit on July 19, 1989.

Existence of Jurisdiction Below

The District Court for the Eastern District of Texas had jurisdiction over this action under 12 U.S.C. § 1819 and 28 U.S.C. § 1345.

## ARGUMENT

I. THE FIFTH CIRCUIT ERRED IN HOLDING THAT *D' OENCH, DUHME* AND § 1823(e) BAR TNB'S SETOFF WHEN TNB WAS TOTALLY INNOCENT AND NOT NEGLIGENT IN ITS ORDINARY AND GOOD FAITH DEALINGS WITH THE FAILED BANK. BY SO HOLDING, THE FIFTH CIRCUIT HAS PLACED ITSELF IN CONFLICT WITH THE SIXTH AND NINTH CIRCUIT COURTS OF APPEAL.

By applying *D'Oench, Duhme* and § 1823(e) to the facts of this case, the Fifth Circuit has ignored the long-recognized limitation that *D'Oench, Duhme* will not apply where ordinary and good faith commercial transactions are involved. *D'Oench, Duhme*, 315 U.S. at 474, 86 L.Ed. at 971 (Jackson, J., concurring). Further, the Fifth Circuit has placed itself in conflict with prior decisions of the Ninth and Sixth Circuit Courts of Appeal which have held that *D'Oench, Duhme* and § 1823(e) do not apply to bar the defenses and claims of wholly innocent parties who are not negligent in discovering the failed bank's wrongdoing. *See FDIC v. Meo*, 505 F.2d 790 (9th Cir. 1974); *FDIC v. Turner*, 869 F.2d 270 (6th Cir. 1989). In doing so, the Fifth Circuit abandons the policy supporting *D'Oench, Duhme*, which is to

estop the assertion of defenses and claims of those who lend themselves to a scheme or arrangement which misleads the FDIC, in favor of the inequitable policy requiring innocent and non-negligent parties to pay for the criminal acts of others.

A. The *D' Oench, Duhme* Doctrine

In *D' Oench, Duhme*, this Court held that a maker of a note who lends himself to a scheme or arrangement that is likely to deceive a bank examiner is estopped to assert any part of the arrangement against FDIC when the maker of the note made the deception possible. The *D' Oench, Duhme* doctrine is based on sound federal policy to protect the FDIC and the funds which it administers from "misrepresentations as to the securities or other assets in the portfolios of banks which (it) insures or to which it makes loans." *D' Oench, Duhme*, 315 U.S.

at 457, 86 L. Ed. at 962. This doctrine has been consistently applied to prevent makers or guarantors of notes from avoiding their obligations to the failed banks, as expressed by the written instruments, by asserting defenses to the obligation such as failure of consideration, fraud, or oral "side agreements". *See, e.g., FDIC v. Cardinal Oil Well Servicing Co.*, 837 F. 2d 1369 (5th Cir. 1988); *FDIC v. McClanahan*, 795 F. 2d 512 (5th Cir. 1986); *FDIC v. Hoover-Morris Enterprises*, 642 F. 2d 785 (5th Cir. Unit B, 1981).

However, the doctrine is not applicable in cases where it would be inequitable to do so. In *D' Oench, Duhme* itself, Justice Jackson pointed out that:

> [the FDIC] would succeed only to the rights which the bank itself acquired where ordinary and good faith commercial transactions

are involved.

*D' Oench, Duhme,* 315 U.S. at 474, 86 L.Ed. at 971 (Jackson, J., concurring).

This has often been cited as an exception to, and limitation on, the *D' Oench, Duhme* doctrine. *See, e.g., FDIC v. Meo, supra; In re: Longhorn Securities Litigation,* 573 F.Supp. 278, 281 (W.D.Ok. 1983); *In re: Kanterman,* 97 B.R. 768, 776 (Bankr. S.D.N.Y. 1989). *Accord, Gunter v. Hutcheson,* 674 F.2d 862, 872-3 (11th Cir.), *cert. denied,* 459 U.S. 826, 103 S.Ct. 60, 74 L.Ed.2d 63 (1982). Thus, the doctrine would not be applicable in a case where the signature of the maker has been forged, *McClanahan, supra,* where there is no negligence on the part of the maker, *Meo, supra,* nor where the bank's criminal acts can in no way be attributed to the maker or guarantor. *Turner, supra.* In cases such as these,

*D' Oench, Duhme* will not bar the assertion of defenses and claims against FDIC since it will only have the rights the bank itself acquired.

B. The Fifth Circuit's opinion is in conflict with prior opinions of the Sixth and Ninth Circuit Courts of Appeals.

In its superficial analysis, the Fifth Circuit mistakenly treated the present case as a typical *D' Oench, Duhme* case. To support is position, the Fifth Circuit cites only *Langley v. FDIC,* 484 U.S. 86, 108 S.Ct. 396, 98 L.Ed.2d 340 (1987), with which it finds "no relevant distinction" from this case. *Texarkana Nat. Bank,* 874 F.2d at 268. However, even a cursory reading of *Langley* reveals the obvious differences in this case. In *Langley,* the Langleys purchased land in Louisiana in 1980, simultaneously executing a note and collateral mortgage with Planters Trust and Savings Bank. This note was renewed

several times, the last renewal being in March, 1982. Soon after default, the Langleys asserted as a defense that the 1980 land purchase and Note had been procured by the bank's misrepresentations regarding the amount of acreage and mineral acres conveyed in the land purchase. *None* of these representations were in writing.

Thus, *Langley* represents the classic *D' Oench, Duhme* case in which the maker of a note seeks to assert an unwritten side agreement to vary the terms of the note. The Langleys obviously lent themselves to an arrangement that was likely to mislead the banking authorities by failing to reduce the representations to writing and making them a part of the loan transaction documents. Further, the Langleys were negligent in failing to discover the fraud when a simple survey and title

search would have immediately revealed the fraud.

By contrast, none of the factors in *Langley* are present here. The scheme to defraud the banking authorities was a *fait accompli* before TNB entered the transaction. The president of GBSB had already forged the signatures of Bell and Gunther and placed the fictitious Bell and Gunther loans on the books of GBSB, representing them to be the assets of the bank. TNB in no way participated in, knew of, or "lent itself" to this fraudulent scheme. It was only after this deceptive scheme was completed that GBSB's president solicited TNB's participation in these fictitious loans. In doing so, he provided TNB with: 1) promissory notes and 2) financing statements purportedly signed by Bell and Gunther; and 3) collateral inspection certificates and financing

statements *signed* by GBSB's president and assistant cashier. (Pl. Ex. 30-31). *All of these instruments were in writing* [6] and were purportedly genuine. Relying on this written documentation, and having no reason to suspect a fraud

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[6] In spite of the abundant *documentary* evidence of the fraudulent misrepresentations of GBSB's president, the Fifth Circuit amazingly asserts that "TNB failed to get the fraudulent representations in writing." *Texarkana Nat. Bank*, 874 F.2d at 268. Although Petitioner is frankly at a loss to conceive what more in the form of documentary evidence could be required than was produced at the trial of this case, evidently the Fifth Circuit would require either meaningless "boilerplate" language or a separate verification by the originating bank that all notes and supporting documents are genuine. Such a requirement is not only absurd, it would be totally ineffective to advance the purposes behind *D'Oench, Duhme*. Further, as Judge Williams noted:

> That kind of meaningless requirement would have added nothing at all to the clear proof in this case that TNB had no knowledge of fraud and that it was a banking transaction of utterly routine nature. *Id.*, 874 F.2d at 272 (Williams, J., dissenting).

on the part of GBSB's president, TNB paid $200,000.00 to purchase a participation in the Bell and Gunther loans.

To TNB, the purchase of the Bell and Gunther loan participations was an ordinary and good faith banking transaction taking place in the normal course of its business. The testimony at trial showed that TNB used the same procedures in purchasing this loan participation that it had in purchasing participations with banks in Little Rock, Dallas and other places, and that this practice was common among banks. (Tr. 193-194). TNB had never before had occasion to believe that GBSB's president had sought to sell a participation in a non-existent loan. (Tr. 194). Further, TNB depended on the representations made by GBSB's president contained in the supporting documents,

just as it would have depended on the representations of the presidents of other banks with which it had participations. (Tr. 193-194).

The district court found that TNB had acted reasonably in relying on these documentary representations of GBSB's president. Significantly, the Fifth Circuit does not dispute these findings by the district court, and Judge Williams in his dissenting opinion concludes that TNB's actions were indeed reasonable. *Texarkana Nat. Bank*, 874 F.2d at 273 (Williams, J., dissenting). Thus, TNB entered into this transaction in good faith and in the normal course of its banking business. TNB was not negligent in its transactions with GBSB, and in no way lent itself or participated in Mr. Fagan's scheme. Rather, TNB was a wholly innocent victim of the

fraudulent scheme of GBSB's president.

By applying *D'Oench, Duhme* in this case, the Fifth Circuit ignores the long recognized principle that where an ordinary and good faith commercial transaction is involved, *D'Oench, Duhme* does not apply, but rather FDIC succeeds only to the rights which the bank itself acquired in the transaction. *D'Oench, Duhme*, 315 U.S. at 474, 86 L.Ed. at 971 (Jackson, J., concurring). *Accord, Meo, supra; Gunter v. Hutcheson, supra.* Further, the Fifth Circuit has placed itself squarely in conflict with the Ninth Circuit which has recognized that the estoppel rule of *D'Oench, Duhme* does not apply when the maker is wholly innocent and was not negligent in discovering the bank's error or wrongdoing. *Meo*, 505 F.2d at 793. In reversing the trial court's decision in favor of FDIC, the Ninth Circuit

concluded that:

> . . . a bank borrower who was neither a party to any deceptive scheme involving, nor negligent with respect to, circumstances giving rise to the claimed defense to his note is not estopped from asserting such defense against the bank's receiver.

*Id.*, 505 F. 2d at 793.

Finally, the Fifth Circuit is in direct conflict with the Sixth Circuit, which has recently held that *D' Oench, Duhme* and § 1823(e) do not apply when the defendant is not a party to the fraud. *Turner,* 869 F. 2d at 275-6. In that case, Mr. Turner executed a blank guaranty and presented it to the president of United American Bank of Knoxville. Subsequently, the guaranty was completed by an unknown person, who filled in the name of the debtor, the amount and changed the bank's name on the guaranty to City and County Bank of Knox County.

In reversing the trial court's judgment in favor of FDIC, the Sixth Circuit held that Turner could not be held liable for the criminal acts of the perpetrator of the fraud who went beyond filling in blank lines. Further, the court noted that Turner took steps to negate the guaranty when he learned of the fraud and that he had no reason to distrust the president of the bank when he gave him the blank guaranty. *Id.*, 869 F.2d at 276. Finally, the court held that holding Turner liable would not further the policies which support *D'Oench, Duhme,* and which "do not include holding a party liable who was not a part of or responsible for a fraudulent scheme." *Id.*, 869 F.2d at 276.

Thus, the Fifth Circuit has placed itself in conflict with the Ninth and Sixth Circuits by barring TNB's setoff,

which in effect holds TNB liable for the criminal acts of GBSB's president, under facts which show that TNB neither knew of the fraud, nor had reason to distrust the president of GBSB, nor was negligent in failing to discover the fraud. By barring TNB's setoff when TNB acted in good faith in purchasing the Bell and Gunther loan participations, purchased them in the normal course of its banking business, and did not participate in or lend itself to Mr. Fagan's scheme to defraud FDIC, the Fifth Circuit attempts to abolish the limitations of the *D'Oench, Duhme* doctrine as set forth in the majority of concurring opinions *D'Oench, Duhme* and relied upon by the Ninth and Sixth Circuits.

II. THE COURT ERRED IN APPLYING 12 U.S.C. § 1823(e) WHEN FDIC-CORPORATE HAD ACQUIRED NO RIGHT, TITLE OR INTEREST IN THE PROPERTY WHICH IS THE SUBJECT MATTER OF THIS SUIT.

In its opinion, the Fifth Circuit held that 12 U.S.C. § 1823(e), the statutory codification of *D'Oench, Duhme*, bars TNB from asserting its setoff based on the fraudulent Bell and Gunther loan participations. The Fifth Circuit held that TNB's asserted setoff tended to diminish FDIC-Corporate's right to collect on the CDs and the TNB loan participations and based its opinion solely on the question of "whether the setoff is based on an 'agreement' within the meaning of § 1823(e)." By so doing, the court of appeals has misconstrued the legal nature of a setoff and has erred as a matter of law in applying § 1823(e) in this case.[7]

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[7] To its credit, FDIC did not assert that § 1823(e) applied in this case, either at trial or in its brief to the Fifth Circuit. Further, FDIC's counsel, in response to questioning of the Fifth Circuit panel at oral argument, conceded that § 1823(e) was

A. TNB's right to setoff was fixed at the time of GBSB's insolvency.

In *Langley v. FDIC, supra,* this Court recognized that § 1823(e) will not bar a claim or defense against FDIC-Corporate if FDIC-Corporate has not acquired any right, title or interest in the subject asset. *Langley,* 98 L. Ed. 2d at 348. The basis of the Fifth Circuit's opinion assumes without analysis that FDIC-Corporate acquired some right, title or interest in the CDs and TNB loan participations upon which it brought suit. By so doing, it ignored the fact that if TNB's setoff was valid, then FDIC-Corporate acquired no right, title or interest in these "assets" and § 1823(e) will not apply. Thus, the initial inquiry in this case must be whether TNB had a right of setoff and, if so, was its setoff

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inapplicable in this case.

valid?

By focusing its inquiry on events taking place and supposed "rights" acquired by FDIC-Corporate subsequent to the insolvency and closure of GBSB, the Fifth Circuit has ignored the longstanding legal and equitable principles recognized by this Court and various circuit courts that the rights and liabilities of a bank and the bank's debtors and creditors are fixed at the declaration of the bank's insolvency and that no additional rights can be created after insolvency. *See, e.g., Merrill v. National Bank of Jacksonville,* 173 U.S. 131, 143, 19 S.Ct. 360, 365, 43 L.Ed. 640, 645 (1899); *FDIC v. Grella,* 553 F.2d 258, 262 (2d Cir. 1977); *American National Bank v. FDIC,* 710 F.2d 1528, 1540 (11th Cir. 1983); *FDIC v. Liberty National Bank & Trust Co.,* 806 F.2d 961, 964 (10th Cir. 1986).

These rights include the right of setoff which is implied from the nature of the dealings between the parties or by operation of law and is not affected by statutes governing bank insolvencies. *Scott v. Armstrong*, 146 U.S. 499, 13 S.Ct. 148, 36 L.Ed. 1059, 1063 (1892). Further, when a bank is placed in receivership, its insolvency justifies the setoff of debts owed that bank against assets of the bank in the possession of its debtor. *Id.*, 36 L.Ed. at 1062.

Thus, upon the insolvency of GBSB, TNB had an equitable right to set off debts owing to GBSB against debts owing TNB from GBSB. Further, both its rights and FDIC-Corporate's rights were fixed on July 27, 1982, when the Texas Banking Commissioner declared GBSB insolvent and placed it in receivership.

B. TNB's Setoff of the fraudulent Bell and Gunther loan participations is

properly characterized as a claim against FDIC-Receiver and, as such, was proper.

Having established that upon GBSB's insolvency, TNB had a right of setoff, the next inquiry must be whether that setoff was proper. Preliminarily, it must be noted that although TNB has asserted its setoff as an affirmative defense to FDIC-Corporate's suit involving the two CDs and TNB loan participations, TNB's setoff is properly characterized as a claim against FDIC-Receiver. *Scott,* 36 L. Ed. at 1062; *First Empire Bank v. FDIC,* 634 F. 2d 1222, 1225 (9th Cir. 1985); *Interfirst Bank Abilene v. FDIC,* 777 F. 2d 1092, 1094 (5th Cir. 1985). Any rights of FDIC-Corporate in the assets to the extent represented by the amount of the Bell and Gunther loan participations (and TNB's liability to FDIC-Corporate on the same) will depend

on the validity of TNB's setoff or claim against FDIC-Receiver.

Therefore, the relevant inquiry is whether TNB properly set off the fraudulent Bell and Gunther loan participations against FDIC-Receiver. Stated differently, was TNB's claim involving the fraudulent Bell and Gunther loan participations provable against FDIC-Receiver?

The Fifth Circuit has held, under facts similar to those in this case, that a claim is provable against FDIC-Receiver if:

> (1) it exists before the bank's insolvency and does not depend on any new contractual obligations arising later; (2) liability on the claim is absolute and certain in amount when suit is filed . . .; and (3) the claim is made in a timely manner . . .

*Interfirst Bank Abilene*, 777 F.2d at 1094 (citing *First Empire Bank v. FDIC*, 572 F.2d 1361, 1367-69 (9th Cir.), *cert.*

*denied*, 439 U.S. 919, 99 S.Ct. 293, 58 L.Ed.2d 265 (1978)).

In that case, after Ranchlander National Bank had been declared insolvent and FDIC appointed as receiver, Interfirst set off four fraudulent loan participations purchased from Ranchlander against assets of Ranchlander in the possession of Interfirst.

The Fifth Circuit held that since Interfirst's fraud claim concerning the loan participations predated the insolvency and was absolute in amount, that:

> there is no *a priori* reason for denying Interfirst, as a bank creditor, a remedy that would be available to any other creditor of Ranchlander who could establish the appropriate facts.

*Id.*, 777 F.2d at 1095.

Therefore, Interfirst had a provable claim against FDIC in the amount of its

participations in the fraudulent loans, and was entitled to a setoff against the assets of Ranchlander.

In the present case, the district court made specific findings supporting its conclusion that TNB was entitled to rescission based on fraud of the Bell and Gunther loan participations. (Mem. Op. Findings 29-40, Conclusion I). The district court went on to conclude that this claim or right to rescission existed before GBSB's insolvency, that FDIC's liability on the claim was absolute and certain in amount when this suit was filed, and that TNB had made its claim, or setoff, in a timely manner. Therefore, since TNB had a provable claim against FDIC in the amount of its participations in the Bell and Gunther loan participations, TNB's setoff of these participation agreements was proper. (Mem. Op.

Conclusion I-II). (R. 706-707).

Significantly, the Fifth Circuit did not challenge the district court's findings in this regard. Judge Williams, in his dissenting opinion, however, examined the evidence and found that the court's findings regarding TNB's right to rescission and the propriety of the setoff were not clearly erroneous. *Texarkana Nat. Bank*, 874 F.2d at 272-274 (Williams, J., dissenting). As discussed in Judge Williams' dissenting opinion, the evidence in this case amply supports the trial court's findings of fact.

Thus, the necessary preliminary examination ignored by the Fifth Circuit in its opinion reveals that TNB had a general right of setoff because of the insolvency of GBSB and further that its specific setoff of the fraudulent Bell and Gunther loan participations was a

provable claim against FDIC-Receiver. Thus, TNB's setoff of the fraudulent Bell and Gunther loan participations was proper.[8]

C. FDIC-Corporate acquired no right, title or interest in the property which is the subject matter of this suit.

FDIC-Corporate claims to have acquired an interest in the CDs and TNB loan participations pursuant to the purchase and assumption agreement entered into with FDIC-Receiver on July 28, 1982. In this purchase and assumption agreement, FDIC-Receiver sold to FDIC-Corporate all those assets remaining in the receivership after FDIC-Receiver had sold certain other assets to First Bank & Trust of Redwater. (Pl. Ex. 1 and 2) (Tr. 31).

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[8] This, of course, assumes that *D' Oench, Duhme* will not apply to bar TNB's setoff claim against FDIC-Receiver. This question has been addressed in Section I of this argument.

It is well established that when there has been a claim against the receiver of an insolvent bank in the form of a setoff, and that setoff is proper, then it is only the balance of assets left *after* the setoff that are considered assets of the receivership. *Scott*, 36 L. Ed. at 1063. *Accord, First Empire Bank*, 634 F. 2d at 1225; *Interfirst Bank Abilene*, 777 F. 2d at 1094.

Thus, if TNB's setoff of the fraudulent Bell and Gunther loan participations were proper, then the only assets left in the receivership were those amounts of the CDs and TNB loan participations remaining in excess of the amounts represented by the Bell and Gunther loan participations. Therefore, if TNB's setoff was proper in this regard, FDIC-Receiver had no assets to the extent represented by the amount

of the fraudulent Bell and Gunther loan participations to convey to FDIC-Corporate and FDIC-Corporate could acquire no "right, title or interest" in these assets.[9]

As has been seen, the trial court made findings of fact supporting its conclusion that TNB was entitled to a rescission of the Bell and Gunther loan participations, based on fraud, prior to GBSB's insolvency, and that TNB's setoff of these loan participation agreements was proper since it had a provable claim against FDIC in the amount of its participation in the Bell and Gunther loan participations. It is significant that the Fifth Circuit did not challenge

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[9] Since FDIC did not challenge the trial court's judgment upholding TNB's setoff to the extent represented by the amounts of the thirteen valid loan participations, FDIC-Receiver also could not convey any right, title or interest in the CDs and TNB loan participations to the extent of the amounts represented by the thirteen valid loan participations.

the district court's findings of fact in this regard. Further, Judge Williams, in his dissenting opinion, held that the district court's findings in this regard were not clearly erroneous and concluded, with the district court, that the setoff was proper under *Interfirst Bank Abilene, supra,* and *First Empire Bank,* 572 F. 2d 1361. *Texarkana Nat. Bank,* 784 F. 2d at 272-274 (Williams, J., dissenting).

Thus, FDIC-Receiver had no assets represented by the amounts of the Bell and Gunther loan participations to convey to FDIC-Corporate in the purchase and assumption agreement of July 28, 1982, and FDIC-Corporate acquired no "right, title or interest" in these assets. Therefore, the Fifth Circuit erred as a matter of law in applying § 1823(e) to bar TNB's assertion of its setoff since § 1823(e) only applies when

FDIC-Corporate has in fact acquired a "right, title or interest . . . in any asset". 12 U.S.C. § 1823(e); *Langley*, 98 L. Ed. 2d at 348.

## CONCLUSION

For all the reasons stated above, this Court should issue a Writ of Certiorari to review the opinion and judgment of the Fifth Circuit with respect to its holding that *D'Oench, Duhme* as codified by § 1823(e) bars TNB from asserting its setoff of the Bell and Gunther loan participations.

Respectfully submitted,

James N. Haltom
Randall D. Goodwin

HUBBARD, PATTON, PEEK,
HALTOM & ROBERTS
Post Office Box 1928
Texarkana, Texas 75504
(214) 794-3341

Counsel of Record for
Texarkana National Bank,
Petitioner

By:
James N. Haltom

## CERTIFICATE OF SERVICE

I hereby certify that three (3) true and correct copies of the foregoing Petition for Writ of Certiorari to the United States Court of Appeals for the Fifty Circuit were forwarded on October 12th, 1989, by United States Mail, postage prepaid, to Mr. T. Ray Guy, Respondent's attorney at the Fifth Circuit, Jenkins & Gilchrist, 3299 Allied Bank Tower, Dallas, Texas 75202-2711; Mr. John L. Douglas, General Counsel and S. DuRoss, Assistant General Counsel, and Mr. Ira H. Parker, Senior Attorney, for FDIC, at 550 17th Street, N.W., Washington, D.C. 20429; and Mr. Kenneth S. Starr, Solicitor General, Department of Justice, Washington, D.C., 20530.

James N. Haltom

APPENDIX A-1

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 88-2216

FEDERAL DEPOSIT INSURANCE CORPORATION,
Plaintiff-Appellant

v.

TEXARKANA NATIONAL BANK,
Defendant-Appellee

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June 2, 1988

Appeal from the United States District Court for the Eastern District of Texas.

Before WILLIAMS, HIGGINBOTHAM and SMITH, Circuit Judges.

This action arose out of the closure and forced receivership of Guaranty Bond State Bank (GBSB). The Federal Deposit Insurance Corporation (FDIC) brought suit for breach of contract against Texarkana National Bank (TNB) to honor amounts alleged to be due to GBSB under two certificates of deposit, three loan

participation agreements, and an Automatic Teller Machine (ATM) Agreement. TNB asserted by way of an affirmative defense that it had properly set off these liabilities against a number of liabilities of GBSB owing to it. TNB also counterclaimed for additional fees arising under the ATM Agreement. The district court found in favor of TNB on all counts.

I. Facts and Prior Proceedings

On July 27, 1982, GBSB was declared insolvent by the Texas Commissioner of Banking. The FDIC was appointed receiver on July 28, 1982. The following day, a purchase and assumption transaction was effectuated under which the FDIC as receiver (FDIC Receiver) transferred certain assets of GBSB to a newly-organized bank, First Bank & Trust Company of Redwater, Texas, (FBTC) in exchange for the assumption of certain

other liabilities of GBSB. The assets of GBSB not transferred to FBTC were transferred to the FDIC in its corporate capacity (FDIC Corporate) in exchange for $11,640,300, which was then passed on to FBTC.

The assets transferred to the FDIC Corporate included the claims asserted against TNB in this litigation. The claims consisted of: (1) two TNB certificates of deposit, each in the amount of $100,000, purchased by GBSB on March 25, 1982 and maturing September 25, 1982; (2) GBSB's proportionate share of collections on three loans originated by TNB, attributable to GBSB's $100,000 participation in such loans; and (3) the unused portion of a $35,000 fee paid by GBSB to TNB at the inception of the five-year ATM agreement.

TNB defended by asserting that it no longer owed any money on these claims

because it had exercised a setoff on August 3, 1982, effective on July 27, 1982.[1] It based the setoff on the following obligations owed to it by GBSB: (1) two $100,000 participations purchased in fictitious loans purportedly made by GBSB to Adam Bell and Cecil Gunther; (2) ten GBSB subordinated debentures, in the aggregate amount of $100,000, purchased by TNB in 1977, that matured in 1984; and (3) participations aggregating $317,120.23 in fifteen legitimate loans made by GBSB.[2] It further

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[1] TNB by letter informed the FDIC of this setoff on August 5, 1982.

[2] On appeal the FDIC does not dispute the portion of the judgment that rests on the setoff of the amounts of the legitimate loans in which TNB had participating interests because the FDIC has in fact collected on those loans. FDIC would have remitted to TNB their participation interest if TNB had not already helped itself by the setoff; thus, the point is moot. The FDIC, however, does not acquiesce in the district court's ruling that the setoff

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counterclaimed asserting that additional money was owed under the ATM agreement.

TNB also asserts it was entitled to its share of the proceeds collected from the FDIC's purchase at a trustee's sale of a deed of trust securing a loan made by GBSB to TexArk Enterprises (TexArk). After default on the loan, the FDIC purchased the real estate securing the loan at the substitute trustee's sale for $75,000, the amount of the loan outstanding. It later sold the property to a third party for $70,000, offering TNB its proportionate share of the actual cash proceeds received less costs of the sale. TNB refused, asserting that its share should be based upon the $75,000 purchase price at the trustee's sale.

On February 8, 1988, the district court entered its Memorandum Opinion and

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was proper.

Order adopting almost verbatim the contentions of TNB. The judgment granted TNB all relief sought while denying any relief to the FDIC. It awarded TNB certain sums for "unpaid ATM service fees and for TNB's share of the supposed proceeds of foreclosure on collateral securing the TexArk loan." The FDIC followed with this appeal.

Specifically, the FDIC urges reversal of the district court's findings that: (1) the Bell and Gunther loans were fictitious, and that various misrepresentations were made to induce TNB's purchase of participations in them, making setoff appropriate; (2) the set off of the subordinated capital debentures was appropriate because the FDIC had consented and because they were due and owing at the time of insolvency; (3) the ATM fee of $35,000 was a one-time, non-refundable fee,

rather than one that should be prorated over the five year term of the agreement; (4) additional fees were owing under the ATM agreement; and (5) the FDIC was obligated to pay to TNB its proportionate share of the TexArk loan based upon the $75,000 proceeds from the trustee's sale.[3]

## II. *Standard of Review*

Rule 52 of the Federal Rules of Civil Procedure provides with respect to findings of fact made after a bench trial:

> Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless

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[3] The district court also found that the FDIC consented to the entire set off by TNB through the actions of James Duval, FDIC's field-liquidator-in-charge. The court found that Duval had apparent authority to consent for the FDIC and that his statements indicated consent. We need not address this finding because it is not determinative of any of the issues before us; however, we briefly address it. See infra note 7.

> clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses.

Fed. R. Civ. P. 52(a). "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." *United States v. United States Gypsum Co.*, 333 U.S. 364, 395, 68 S.Ct. 525, 542, 92 L.Ed. 746 (1948); *Amstar Corp. v. Domino's Pizza, Inc.*, 615 F.2d 252, 258 (5th Cir.), *cert. denied*, 449 U.S. 899, 101 S.Ct. 268, 66 L.Ed.2d 129 (1980).

As is the case here, however, we have shown caution in reviewing district court findings which are essentially verbatim recitals of the prevailing party's proposed findings and conclusions. As we stated in *Amstar*

*Corp.*:

> While the "clearly erroneous" rule of Fed. R. Civ. P. 52(a) applies to a trial judge's findings of fact whether he prepared them or they were developed by one of the parties and mechanically adopted by the judge, "we can take into account the District Court's lack of personal attention to factual findings in applying the clearly erroneous rule."

615 F. 2d at 258 (quoting *Wilson v. Thompson,* 593 F. 2d 1375, 1384 n. 16 (5th Cir. 1979)). The Ninth Circuit Court of Appeals has similarly indicated that strict scrutiny of "rubber-stamped" findings is appropriate. *See Smith International, Inc. v. Hughes Tool Co.*, 664 F. 2d 1373, 1375 (9th Cir.), *cert. denied,* 456 U. S. 976, 102 S. Ct. 2242, 72 L. Ed. 2d 851 (1982).

III. *Setoff as to the Fictitious Loans*[4]

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[4] Part III of the opinion reflects the views of Judge Higginbotham and Judge Smith. Judge Williams dissents to the application of the *D' Oench, Duhme* doctrine in an appended opinion.

(1) The district court found setoff proper by TNB because the Gunther and Bell loans were based on fraud. The GBSB's officers induced TNB to participate in the loans with misrepresentations. The court found that the statements made by the president of GBSB that the signatures of Bell and Gunther on their respective loan documents, security agreements, and supporting documents were genuine and that the collateral had been personally inspected by the officers of GBSB were material and fraudulent. The court further found that TNB's reliance on the statements was justified making setoff before insolvency appropriate.

FDIC seeks to have the setoff invalidated under *D' Oench, Duhme & Co. v. FDIC*, 315 U.S. 447, 62 S.Ct. 676, 86 L.Ed. 956 (1942). The statutory codification of *D' Oench, Duhme* at 12

U.S.C. §1823(e) applies to an "agreement which tends to diminish or defeat the right, title or interest of the [FDIC] in any asset acquired by it under this section, either as security for a loan or by purchase ..." TNB's asserted setoff tends to diminish FDIC's right to collect on the obligations it seeks to enforce against TNB. Thus, the question before us is whether the setoff is based on an "agreement" within the meaning of § 1823(e).

The meaning of "agreement" in the statute was clarified in *Langley v. Federal Deposit Insurance Corp.*, 484 U.S. 86, 108 S.Ct. 396, 98 L.Ed.2d 340 (1987). In *Langley*, the Supreme Court applied § 1823(e) to bar the defense that a note which FDIC sought to enforce had been procured by fraud in the inducement. Recalling that *D'Oench, Duhme* itself dealt with a note whose

maker "lent himself to a scheme or arrangement whereby the banking authority . . . was likely to be misled," the Court reasoned:

> Certainly, one who signs a facially unqualified note subject to an unwritten and unrecorded condition upon its repayment has lent himself to a scheme or arrangement that is likely to mislead the banking authorities, whether the condition consists of performance of a counterpromise (as in *D' Oench, Duhme*) or of the truthfulness of a warranted fact.

*Langley*, 484 U.S. at _____, 108 S.Ct. at 402. We find no relevant distinction between this case and *Langley*. TNB seeks to set off these two loans on the ground that fraudulent representations by GBSB's officers induced TNB to participate in the fictitious transactions. As in *Langley*, those fraudulent representations were part of an "agreement" within the meaning of § 1823(e). TNB failed to get

the representations in writing. Therefore, *D' Oench, Duhme*, as codified in § 1823(e), bars TNB from asserting a setoff based on those representations.

TNB cannot escape the statutory bar by arguing that it was the fictitious loans underlying the loan participation agreements that were likely to mislead bank examiners. Under the teaching of *Langley*, the unrecorded representations by GBSB officers are part of the agreement relevant to application of § 1823(e). By failing to get the representations in writing, TNB participated in an arrangement likely to mislead FDIC. That the agency was also misled by the fictitious underlying loans does not change the analysis.[5]

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[5] While we need not address the FDIC's other arguments as to why setoff was improper since *D' Oench, Duhme* applies, we briefly note them. First, FDIC argues that setoff was improper because FDIC corporate's rights intervened to bar TNB's claim to the

## IV. *The Setoff of the Subordinated Debentures*

The district court found that TNB could setoff its ten subordinated capital debentures of GBSB in the total face amount of $100,000.00.[6] The court found that the FDIC had given prior consent; that the debentures were due and owing as a result of the insolvency;

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setoff. It further argues that rescission based on fraud was not a proper basis for setoff. Finally, as to the argument by TNB that the entire setoff was proper because of consent, *see infra* note 7.

[6] The subordinated debentures, maturing on July 15, 1984, specifically provided as follows:

> The indebtedness of the Bank evidenced by the Capital Debentures shall be junior and subordinate to the obligations of the Bank to depositors and other creditors . . . All obligations to depositors or creditors--except any expressly subordinated or made equal to the debentures--shall be paid in full before any payment shall be made on the account of the principal or interest on the Debentures.

and that there was a mutuality of obligations between GBSB and TNB. The district court's findings are clearly erroneous as to these debentures for at least two reasons regardless of consent by the FDIC.[7] Equity generally prevents

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[7] TNB argues that it was entitled to the offset because of consent by the FDIC. This issue is not relevant on appeal because as is discussed above, even assuming consent was properly given, TNB still does not prevail. We explain the issue briefly, however.

Under 12 U.S.C.A. § 1828(i)(1), the FDIC clearly has the power to consent to a setoff. The Federal Banking Statute provides:

> No insured State non-member (except a District Bank) shall, without prior consent of the Corporation, reduce the amount or retire any part of its common or preferred capital stock, or retire any part of its capital notes or debentures.

12 U.S.C.A. § 1828(i)(1). The district court found that "by the acts of Duval, FDIC gave its prior consent to the setoff." This finding is clearly erroneous. The statement made by the field-liquidator-in-charge to officers of TNB suggesting that a setoff might be appropriate, simply stating "have you considered a setoff?", is not enough to create consent. The statement was made

when two officers of TNB visited Duval at the former offices of GBSB to discuss resolving the relations between former GBSB and TNB. The statement is more properly characterized as "food for thought."

The court, among other theories, found consent based on Duval's apparent authority. This basis was clearly erroneous. Reliance on this statement was not reasonable. *See Wells Fargo Business Credit v. Ben Kozloff, Inc.*, 695 F.2d 940 (5th Cir.), *cert. denied*, 464 U.S. 818, 104 S.Ct. 77, 88 L.Ed.2d 89 (1983).

The district court also found equitable estoppel and ratification by the FDIC of the "consent" given by Duval because of the FDIC's lack of any written objection until May. However, TNB failed at trial to show when the FDIC received notice of Duval's statements. From the record, the first evidence of notice was written notice of the setoffs totaling $495,873.12 by letter dated August 5, 1982. FDIC then informed TNB that it in no way consented to the setoff by written objection the following May. Any delay in this written response was not unreasonable, especially in light of the six-year applicable statute of limitations to bring a suit for damages. 28 U.S.C. § 2415(a). This delay does not constitute ratification or estoppel. *See Land Title Co. of Dallas, Inc. v. F.M. Stigler, Inc.*, 609 S.W.2d 754, 756 (Texas 1980) (for ratification, the principal must retain the benefit of an

a subordinated creditor from enhancing its claim at the expense of other creditors, and these debentures, as a matter of law, do not have mutuality of obligations with the debts owed by TNB to GBSB. We consider these two controlling principles in turn.

A. *Equitable Considerations*

It is undisputed that an equitable right to setoff can arise when there are mutual debts, or that insolvency of one party may justify setoff by the other. Because this right is an equitable right, however, equitable considerations must come into play to limit the right where necessary. *Scott v. Armstrong*, 146 U.S. 499, 507, 13 S.Ct. 148, 150, 36 L.Ed. 1059 (1892). In cases such as

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unauthorized act of his agent after requiring full knowledge). *See also Moody v. United States*, 783 F.2d 1244, 1246 (5th Cir. 1986) (for equitable estoppel, detrimental reliance must be reasonable).

this, where a party voluntarily agrees to a claim subordinate to those of other creditors, equity is better served by preventing a setoff which would enhance the claims of that creditor at the expense of other creditors with a higher priority. *Interfirst Bank Abilene v. FDIC,* 777 F.2d 1092, 1096 (5th Cir. 1985). To allow setoff would defeat the priority protections afforded depositors and other creditors, defeating their expectations as well.

B. *No Mutuality of Obligations*

Also, as a matter of law, the subordinated debentures do not meet the test of mutuality of obligations to make setoff proper. Setoff is justified only if the two claims or demands "mutually exist between the same parties." *Dallas/Ft. Worth Airport Bank v. Dallas Bank & Trust Co.*, 667 S.W.2d 572, 575 (Tex. App.--Dallas 1984, no writ).

In *FDIC v. de Jesus Velez*, 678 F.2d 371, 376 (1st Cir. 1982), the court held that promissory notes executed by two individuals and payable to an insolvent bank and debentures of that bank purchased by the two individuals were not "mutually extinguishable" because the debentures were specifically made subordinate to the claims of all other depositors and creditors of the bank. Consequently, no setoff could be allowed. Similarly, in this case, the debentures cannot be made "mutually extinguishable" with the obligations of TNB to GBSB because of their subordinate quality.

TNB purchased these notes with full knowledge and notice of the terms thereof. It should not now be able to rely on an equitable remedy to place itself in a preferred position vis-a-vis other creditors and depositors of GBSB.

We hold that the district court was in error in giving priority, whatever the claimed reason, to these subordinate obligations.

## V. *The ATM Agreement Fee*

### A. *The Initial Fee*

The district court concluded, as a matter of law, that the $35,000.00 fee paid by GBSB to TNB was for the initial right to participate in the ATM system in 1981 and that GBSB received full consideration therefor.[8] The fee was a one-time, non-refundable payment for the

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[8] The ATM agreement provides:

> 4. Charges and Expenses. Participant shall pay the following charges and expenses as provided below:
>
> (a) Initial Participation Fee--Participant shall pay to TNB, on or before November 1, 1981, the sum of $35,000.00 *for the initial right to participate* in the system in 1981, and for the term hereof with payment of other prescribed fees . . . . (emphasis added).

initial capital improvement costs that were necessary to put together the structure from which the ATM system could be operated.

When the settled rules of contract construction are applied, it is clear the district court's interpretation of the agreement was correct. Written contracts are interpreted primarily by looking to the language of the instrument in an attempt to ascertain the true intentions of the parties. *Universal CIT Credit Corp. v. Daniel*, 150 Tex. 513, 243 S.W.2d 154, 157-58 (1951). The record establishes that both parties understood the fee to be a one-time, non-refundable fee. GBSB is not entitled to any refund on the fee.

B. *Other Fees Under the ATM Agreement*

The district court also awarded $12,633.25 plus interest for other unpaid ATM service fees incurred by GBSB

prior to June 28, 1982. The FDIC on appeal does not dispute this finding except to the extent that it asserts TNB sued the wrong party for recovery. The FDIC argues that even if the claim is valid, it is not recoverable against the FDIC Corporate, but against the FDIC Receiver. We find FDIC's argument without merit.

In *Woodbridge Plaza v. Bank of Irvine*, 815 F.2d 538, 541-42 (9th Cir. 1987), the court made it clear that the FDIC Corporate is liable to the insolvent bank's unassumed creditors when FDIC Receiver fails to leave adequate assets in the receivership to pay the unassumed creditors' claims. *See also First Empire Bank v. FDIC*, 572 F.2d 1361, 1371 (9th Cir. 1978).[9] The

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[9] While *Woodbridge* relied on California law, the Texas statute is in accord with the statutes on point in that case. The Texas statute forbids any preference as to creditors providing

evidence at trial showed that, just as in *Woodbridge*, the FDIC allowed FBTC to choose which assets and liabilities it wished to assume in the purchase and assumption agreement. FDIC then sold the remaining assets to FDIC Corporate, leaving virtually no assets remaining. The FDIC Corporate is liable, therefore, for the ATM fees the district court found owed to TNB.

VI. *The Texarkana Loan Sales*

TNB contests the amount owed to it under the TexArk loan participation

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that:

> . . . any attempt by any officer, director, or agent to transfer, assign, convey, mortgage or pledge any asset of the bank or to credit any lien thereon or in any manner to prefer any depositor or creditor of the bank after the posting of such notice (of insolvency) or in contemplation thereof shall be void.

Tex. Rev. Civ. Stat. Ann. Art. 342-804 (Vernon 1973). *See also* 12 U.S.C. § 91.

agreement it purchased from GBSB around October 22, 1981. On or about March 1, 1983, the TexArk loan was in default and the FDIC Corporate, as successor-in-interest to GBSB, caused the property described in the deed of trust to be sold. The FDIC Corporate was also the purchaser at the sale.

By the terms of the TexArk loan participation agreement, GBSB and the FDIC Corporate agreed, in pertinent part, to the following:

> [O]ur sole responsibility to you being . . . to account to you for your pro rata share of the net amount of *all payments actually received* by us with respect to the said note. (emphasis added).

The FDIC purchased the TexArk property at the substitute trustee sale for $75,000.00, the amount outstanding on the loan. TNB claims that it is entitled to its pro rata share of this amount. TNB argues that when the FDIC purchased the property, proceeds were

available for distribution, extinguishing the debt without deficiency. The district court agreed with TNB, finding the FDIC liable for $20,000, its pro rata share of the $75,000 figure. We must find to the contrary, looking to the substance of these transactions.[10]

The FDIC properly undertook to calculate the amount owed to TNB under the loan participation agreement using the figure of $70,000.00, the subsequent sale price to a third party of the property. The purchase by the FDIC at the trustee's sale was nothing other than a paper transaction. The evidence

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[10] We are not bound by the clearly erroneous rule but review and interpret the contract language *de novo* as a question of law. *Carpenters Amended & Restated Health Ben. Fund v. Holleman Constr. Co.*, 751 F.2d 763, 766 (5th Cir. 1985). *See also, Austin v. Decker Coal Co.*, 701 F.2d 420, 425 (5th Cir.), *cert. denied*, 464 U.S. 938, 104 S.Ct. 348, 78 L.Ed.2d 314 (1983).

is undisputed that no money actually changed hands. Rather, the "purchase" represented a bookkeeping entry, cancelling the outstanding portion of the debt. Thus, no payment was "actually received" as required by the contract language until the third party sale. The district court was incorrect as a matter of law in its finding that the price at the trustee's sale was the correct figure to calculate the amount owed to TNB. *See Jefferson Sav. & Loan Ass'n v. Lifetime Sav. & Loan Ass.*, 396 F.2d 21, 22 (9th Cir. 1968). The correct amount appears to be $18,669, 26.67% of the $70,000 received without deduction for sale expenses. The district court refused to deduct expenses in the trustee's sale from the amount owed to TNB, finding that the FDIC failed to prove the issue. This finding is not clearly erroneous in

light of the vagueness and uncertainty of the evidence at trial. Moreover, the FDIC only raised the expense issue during oral argument. Arguments raised on appeal must be included in the appellate brief or they may be considered waived. *Franceski v. Plaquemines Parish School Board*, 772 F. 2d 197, 199 n. 1 (5th Cir. 1985).

## VII. *Conclusion*

We reverse the district court's allowance of setoff as to the fraudulent loans and as to the subordinated debentures. Setoff was not appropriate on the loans because of the *D'Oench, Duhme* Doctrine. Setoff was not authorized as to the subordinated debentures. They were subordinate and equitable concerns and the fact that the debentures were not "mutually extinguishable" with the debts owed by TNB to GBSB require that the subordinate

status be enforced.

As to the ATM agreement, we affirm the district court's finding that the initial fee was non-refundable and that GBSB received consideration thereof. We also affirm the award of the other fees under the agreement as owing by the FDIC Corporate.

As to the purchase at the trustee's sale by the FDIC and then subsequent sale of the TexArk property, we reverse the district court's use of the price at the trustee's sale to determine the amount owed under the loan participation agreement. The correct figure was the subsequent sale price.

AFFIRMED IN PART; REVERSED IN PART.

JERRE S. WILLIAMS, Circuit Judge, dissenting in part:

A. *Applicability of D' Oench, Duhme*

I respectfully dissent to Section III. I find the application of the

*D' Oench, Duhme* doctrine to these facts unwarranted and undesirable. The majority rests its holding on the assertion that this case is controlled by *Langley,* in which the doctrine was applied. I find, however, not only *Langley,* but also the typical *D' Oench, Duhme* case, clearly distinguishable from the facts of the case before us.

The *D' Oench, Duhme* doctrine typically applies where a person, usually a borrower, is a party to a transaction that has misled the FDIC. Such was the situation in *Langley.* A party to such a transaction can expect to be obligated to investigate the transaction thoroughly and responsibly. For cases involving the obligations of parties in such transactions, *see e.g., FDIC v. Cardinal Oil Well Servicing Co.,* 837 F.2d 1369 (5th Cir. 1988) (borrowers "lent themselves to a scheme" under

*D' Oench, Duhme* by failing to revoke unconditional guaranty covering future loans); *FDIC v. McClanahan*, 795 F. 2d 512 (5th Cir. 1986) (borrower signed blank promissory note); *FDIC v. Hoover-Morris Enteprises* 642 F. 2d 785 (5th Cir. Unit B, 1981) (borrower participated in unwritten side agreement which would defeat FDIC's interest in the loan).

In contracts, TNB "participated" in the loan only after it was made, and in no way participated in the underlying transaction. Just as did the FDIC, TNB came into the picture after the deceptive scheme was completed. The fictitious loan had already been made. In buying a portion of the loan after it was negotiated, TNB in no possible way contributed to the concealed deceptive scheme, unlike the debtor in *Langley*. The scheme was already complete. In *Langley*, the borrowers were the

participants in the transaction that misled the FDIC. Not so was TNB.

Under 12 U.S.C. § 1823(e), which codifies *D' Oench, Duhme*, our analysis is the same. Unlike the majority, I find the relevant "agreement[s] which tend to diminish or defeat the right" of the FDIC to be the fraudulent loans themselves. TNB only came into the picture after the fraudulent loans were made.

Banks, in the normal course of business, cannot be expected to investigate thoroughly for fraud totally concealed from them in loan participation agreements into which they enter. I find it hard to imagine a requirement that would tie up to a greater extent the normal day to day banking business in placing such loans with other banks. The majority view implies that a simple "boilerplate"

written form that representatives were not fraudulent would be sufficient to satisfy *D'Oench, Duhme* and the statute. That kind of meaningless requirement would have added nothing at all to the clear proof in this case that TNB had no knowledge of fraud and that it was a banking transaction of utterly routine nature. I do not read *D'Oench, Duhme* nor the statute to establish an "I am my brother's keeper" relationship in arms length bank dealings so that a completely innocent bank is responsible for the concealed fraud of another bank. Yet this is what the majority view demands. I cannot accept that demand as the law.

Because I find *D'Oench, Duhme* inapplicable, the FDIC's counter arguments need to be addressed.[1] I

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[1] *See* note 5 in the opinion of the Court.

discuss each in turn.

B. *Rescission Based on Fraud As Grounds for A Setoff*

The district court found setoff proper by TNB because the Gunther and Adams loans were based on fraud. The GBSB's officers induced TNB to participate in the loans with misrepresentations. The court found to be material the statements made by the president of GBSB which were that the signatures of Bell and Gunther on their respective loan documents, on the security agreements, and on the supporting documents were genuine and that the collateral had been personally inspected by the officers of GBSB. The material statements were fraudulent. The court further found that TNB's reliance on the statements was justified, making setoff before insolvency appropriate. This finding is not clearly erroneous.

In a case with similar facts we found setoff appropriate. *Interfirst Bank Abilene v. FDIC*, 777 F.2d 1092 (5th Cir. 1985). *See also First Empire Bank v. FDIC*, 572 F.2d 1361, 1367-69 (9th Cir. 1978), *cert. denied*, 439 U.S. 919, 99 S.Ct. 293, 58 L.Ed.2d 265 (1978). In *Interfirst*, the court held that a participating bank could set off against debts owed to a lead bank upon proving its claim of entitlement to rescission based on fraud. The participating bank (Interfirst) had purchased participations in four loans, two of which were fraudulent. After the lead bank was declared insolvent, the FDIC made a demand on Interfirst for funds held. The bank responded by exercising a setoff, and we affirmed.[2]

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[2] FDIC concedes that there is an equitable right of setoff when there are mutual debts and that the insolvency of one party may justify setoff by the other. *Scott v. Armstrong*, 146 U.S.

Interfirst was found to be entitled to a setoff because its claim was provable. A claim is provable if "(1) it exists before the bank's insolvency and does not depend on any new contractual obligations arising later; (2) liability on the claim is absolute and certain in amount when suit is filed . . . , and (3) the claim is made in a timely manner, well before any distribution of the assets of the receivership other than a distribution through a purchase and assumption agreement." 777 F.2d at 1094. Interfirst asserted provability on two grounds, one of them being entitlement to rescission based on fraud. The court upheld Interfirst's actions under either of the bases argued, finding also the required "mutuality" of obligations

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499, 507-08, 13 S.Ct. 148, 150, 36 L.Ed. 1059 (1892).

making setoff appropriate. 777 F.2d at 1095.

As in *Interfirst*, TNB's claim for rescission based upon fraud predated the insolvency of GBSB and was absolute in amount. The fraud occurred at the time of the inducement to participate in the loans. TNB's claim was also made in a timely manner. As in *Interfirst*, while TNB did not seek rescission until the lead bank was declared insolvent, it did so before the distribution of assets of the receivership. Thus, for TNB to have a right to rescission, the only issues left to address are the actual elements of the claim of fraud.

A party seeking rescission under Texas law must establish five elements: (1) that a false representation was made by a party with authority; (2) that the party making the representation was aware of its falsity; (3) that the

representation was made with intent to induce the receiving party to take some action; (4) that the receiving party acted in reliance on the misrepresentation; and (5) that such reliance was detrimental. *Chemetron Corp. v. Business Funds, Inc.*, 682 F. 2d 1149, 1171-72 (5th Cir. 1982), *vacated on other grounds*, 460 U. S. 1013, 103 S. Ct. 1254, 75 L. Ed. 2d 483 (1983). The district court correctly found from the evidence at trial, that the GBSB's president invented the two loans and presented them as legitimate to try to procure the participation of other banks. Even one of the FDIC's witnesses admitted that the loans were fictitious.

As to the reliance, both parties agree it had to be reasonable.[3] The

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[3] The FDIC claims that the district court as a matter of law erred by not entering a finding on reasonableness. The court did enter a finding that reliance was justified,

FDIC asserts that TNB's reliance on the president's statements was not reasonable and that they should have researched the loans independently to determine their validity. The FDIC's assertions cannot stand. While it is true that a party is under a duty to exercise reasonable care and diligence in relying on statements of an adverse party, a defrauded party:

> is under no duty to make an investigation to discover the existence of fraud, unless and until he has acquired some knowledge of facts that would put a reasonable prudent person on inquiry.

*Traylor v. Gray*, 547 S.W.2d 644, 653 (Tex. Civ. App. --Corpus Christi 1977, writ ref'd n.r.e.). In Traylor, the parties had had prior business dealings. A "simple telephone call" would have led to the discovery of the fraud. The

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however, which suffices as a finding of reasonableness.

subject matter and method of dealing between the parties, however, was no different from previous transactions, making the reliance reasonable. *Id.* We are faced with the same situation here.

TNB had participated in at least fourteen other loan participations originated by GBSB with the same degree of inquiry and without problem. Each of the loans was valid and had been paid in its entirety. In fact, the testimony at trial showed that TNB used the same procedures in loan participations it had purchased with banks in Little Rock, Dallas, and other places, and that this practice was common among banks. TNB's practice depended upon the representations of the officers of other banks as to the validity of the documents for the particular loan transaction. Banks are entitled to assume "that when dealing with another

bank in a commercial undertaking that bank is competent to conduct its own affairs." *See Barclays Bank D.C.O. v. Mercantile National Bank*, 481 F.2d 1224, 1235 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139, 94 S.Ct. 888, 39 L.Ed.2d 96 (1974). Thus, TNB's practice was reasonable.

The FDIC argues that the size of the Gunther and Bell loans, each $100,000, should have put TNB on notice that additional investigation was needed. The record, however, indicates that TNB purchased at least two other loans which were around the same amount as the two fraudulent loans and which were valid and subsequently paid. TNB had purchased participations in loans made to James C. Carlow in the aggregate amount of $88,000, and to Freeman Nurseries in the amount of $120,000. There was nothing unusual in the size of

the Gunther and Bell loan participation transactions that should have put a reasonable, prudent banker on notice of any irregularities, creating a duty of further inquiry. The representations by GBSB officers that the loans were genuine, and that the collateral existed and had been inspected, were made in the ordinary course of doing business and did not differ from other prior loan participation agreements between the parties. We conclude that the district court's finding of a right to rescission based upon fraud was not clearly erroneous.

C. *Possible Intervention of FDIC Corporate's Rights to Bar TNB's Right to Set Off the Fictitious Loans*

Finally, the FDIC argues that the rights of FDIC Corporate intervened to bar TNB's rights to a setoff as to the fictitious loans. Because setoff was proper as to the two fraudulent loans,

however, it is only "the balance, if any, after the setoff is deducted, which can justly be held to form part of the assets of the insolvent." *Scott*, 146 U.S. at 510, 13 S.Ct. at 151. Thus, the FDIC Receiver had no assets represented by the Bell and Gunther loan participations because GBSB did not have the assets. So it could not convey them to the FDIC Corporate in the purchase and assumption transaction. Intervention by the FDIC Corporate as to these assets was impossible. It never had them.

In summary, I dissent because I would affirm the district court's finding that setoff was proper. The *D'Oench, Duhme* doctrine was not applicable, and the majority view sets up a grave and unjustified impediment to normal banking operations. Two further claims of the FDIC are without merit.

They are, first, that FDIC Corporate's legal operations constituted a bar to TNB's right to setoff, and second, that the district court was in error in finding the right of TNB to rescind because of fraud.

APPENDIX A-2

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 88-2216

FEDERAL DEPOSIT INSURANCE CORPORATION,
Plaintiff-Appellant

v.

TEXARKANA NATIONAL BANK,
Defendant-Appellee

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July 19, 1989

Appeal from the United States District Court for the Eastern District of Texas, Joe J. Fisher, Judge.

ON PETITIONS FOR REHEARING
AND SUGGESTION FOR REHEARING EN BANC

(Opinion June 2, 1989, 5th Cir., 874 F.2d 264)

Before WILLIAMS, HIGGINBOTHAM and SMITH, Circuit Judges.

PER CURIAM:

The Petition for Rehearing of Appellee, Texarkana National Bank, is DENIED.

The Petition for Rehearing of

Appellant, Federal Deposit Insurance Corporation, is GRANTED.

The Court withdraws the second paragraph of Section V B of its opinion. The Court by doing so, avoids concluding that Texarkana National Bank as a creditor is entitled, nevertheless, to full recompense rather than to a pro-rata share of its claim to the same extent as other creditors.

The Court reaches the same result of full payment of the TNB claim of $12,633.25 plus interest by substituting the following paragraph for the paragraph deleted above:

> Under the case of *Interfirst Bank Abilene, N.A. v. FDIC*, 777 F.2d 1092 (5th Cir. 1985), this undisputed amount is properly set off in full as a contract claim against GBSB's contract claims against TNB.

No member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Federal

Rules of Appellate Procedure and Local Rule 35), the Suggestion for Rehearing En Banc is DENIED.

APPENDIX B-1

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS
TEXARKANA DIVISION

FEDERAL DEPOSIT INSURANCE
CORPORATION, IN ITS CORPORATE
CAPACITY

VS. CIVIL ACTION NO. TX-86-122-CA

TEXARKANA NATIONAL BANK

Honorable Paul E. Ridley
Jones, Day, Reavis & Pogue
2300 LTV Center
2001 Ross Avenue
Dallas, Texas 75201
ATTORNEY FOR PLAINTIFF

Honorable James N. Haltom
Hubbard, Patton, Peek, Haltom &
Roberts
700 Texarkana National Bank Building
P.O. Box 1928
Texarkana, Texas 75504
ATTORNEY FOR DEFENDANT

MEMORANDUM OPINION WITH
FINDINGS OF FACT AND
CONCLUSIONS OF LAW

This is a cause of action for an alleged breach of contract and on a debt involving the alleged failure of Defendant to honor and pay amounts due under two certificate of deposit, three

loan participation agreements, and an Automatic Teller Machine ("ATM") Agreement entered into by Guaranty Bond State Bank ("GBSB"), a failed bank. Defendant asserts by way of affirmative defense that it properly set-off the certificates of deposit and loan participations against certain liabilities of GBSB owing to the Defendant. Defendant further alleges that Plaintiff through its agent suggested and authorized the set-off and that Plaintiff has, by its subsequent actions or inactions, waived or is estopped to complain about the set-off transaction, and has ratified the set-off. Defendant by way of counterclaim alleges that certain amounts are due it for ATM system fees incurred prior to the closing of GBSB and for its pro rata share of the proceeds from the sale of collateral on a loan to TexArk

Enterprises, Inc. from GBSB in which Defendant purchased a participation interest. In the alternative, Defendant alleges that the loans underlying two of the GBSB participations were fraudulent when GBSB sold them to Defendant, and that Defendant is entitled to reimbursement of all monies paid for these participations from Plaintiff. Further, Defendant alleges the loans underlying the remaining GBSB participations have been paid in full to Plaintiff, and Plaintiff has failed to pay Defendants its proportionate share, as provided in the participation agreements.

Pursuant to Rule 52, Federal Rules of Civil Procedure, the Court, having considered all the evidence and arguments of counsel, makes the following findings of fact and conclusions of law:

1. Plaintiff FDIC is a corporation organized under the laws of the United States of America, 12 U.S.C., Section 1811 et seq., and brings this action in its corporate capacity.

2. Defendant The Texarkana National Bank ("TNB") is a national banking association chartered by the United States of America, with its principal place of business in Texarkana, Texas.

3. Prior to July 28, 1982, Guaranty Bond State Bank ("GBSB") was a banking institution organized and existing under the laws of the State of Texas.

4. On or about July 27, 1982, the Banking Commissioner of the State of Texas ("Commissioner") determined that GBSB was insolvent and ordered it closed and its affairs liquidated pursuant to TEX. REV. CIV. STAT. ANN. Arts. 342-803 and 342-806.

5. On or about July 28, 1982, the

Commissioner tendered to FDIC the *appointment as receiver of GBSB* pursuant to TEX. REV. CIV. STAT. ANN. Art. 489b. FDIC accepted appointment as receiver of GBSB pursuant to 12 U.S.C., Sec. 1821(e).

6. On or about July 29, 1982, the FDIC entered into a purchase and assumption agreement with First Bank & Trust--Redwater to purchase certain assets and assume certain liabilities of GBSB. Also on or about July 29, 1982, the FDIC as receiver sold all remaining GBSB assets, including all of the assets, choses (sic) in action and claims asserted in this lawsuit, to FDIC, in its corporate capacity, pursuant to 12 U.S.C. Sec. 1823(e).

7. GBSB purchased from TNB on March 25, 1982, Certificates of Deposit No. T711017 and T711018, each in the amount of $100,000.00. These certificates of deposit accrued interest at the rate of

13 1/2% and by their terms were to mature on September 25, 1982. These certificates of deposit were not pledged or otherwise encumbered by GBSB for any obligations or debts of GBSB to TNB.

8. On or about December 30, 1981, GBSB purchased from TNB, for $100,000.00, a 50% participation in a certain loan in the amount of $200,000.00 made by TNB to E-Z Mart Stores, Inc. on December 30, 1981.

9. On or about March 23, 1979, GBSB purchased from TNB for $100,000.00 a participation in a certain loan in the amount of $3,000,000.00 made by TNB to Southwest Interests, Inc. on March 15, 1979.

10. On or about June 12, 1979, GBSB purchased from TNB for $100,000.00 a participation in a certain loan in the amount of $1,500,000.00 made by TNB to Southern Clinic Properties, Inc. on June

1, 1979.

11. Each of the participation agreements GBSB purchased from TNB referred to in Paragraphs 8, 9 and 10 above gave TNB the right to repurchase all or any part of the participation at any time for a price equal to the principal amount of the participation with adjustments of interest to date.

12. TNB exercised its right of repurchase in each of the participation agreements referred to in Paragraphs 8, 9 and 10 above through its set-off of August 3, 1982, effective July 27, 1982. TNB properly credited GBSB with the remaining principal amount owing on each participation referred to in Paragraphs 8, 9 and 10 above and the interest accrued through July 27, 1982.

13. On or about November 4, 1981, GBSB and TNB entered into an ATM Agreement entitling GBSB customers to use a system

of ATMs established and operated by TNB. At or about the time the ATM Agreement was executed, GBSB paid TNB an "initial participation fee" of $35,000.00.

14. The initial participation fee of $35,000.00 was for the right to participate in the ATM system in the year 1981 and was non-refundable.

15. GBSB fully participated in the ATM system from November 4, 1981 through June 29, 1982.

16. On or about November 23, 1981, TNB purchased from GBSB, for $23,000.00, a participation in a certain loan in the amount of $200,000.00 made by GBSB to Aubrey Adams, on November 23, 1981.

17. On or about March 24, 1982, TNB purchased from GBSB, for $25,000.00, a participation in a certain loan in the amount of $25,000.00 made by GBSB to James M. Carlow, on February 2, 1982.

18. On or about March 24, 1982, TNB

purchased from GBSB, for $8,000.00, a participation in a certain loan in the amount of $8,000.00 made by GBSB to James M. Carlow, on January 27, 1982.

19. On or about June 15, 1982, TNB purchased from GBSB, for $15,000.00, a participation in a certain loan in the amount of $15,000.00 made by GBSB to James M. Carlow, on June 15, 1982.

20. On or about May 5, 1982, TNB purchased from GBSB, for $15,000.00, a participation in a certain loan made by GBSB to James M. Carlow, in the amount of $15,000.00, on May 5, 1982.

21. On or about March 24, 1982, TNB purchased from GBSB, for $25,000.00, a participation in a loan made by GBSB to James M. Carlow in the amount of $25,000.00, on January 22, 1982.

22. On or about May 4, 1982, TNB purchased from GBSB, for $7,000.00, a participation in a certain loan made by

GBSB to E. D. Steptoe, in the amount of $8,000.00, on March 9, 1982.

23. On or about May 19, 1982, TNB purchased from GBSB, for $12,000.00, a participation in a certain loan made by GBSB to E. D. Steptoe, in the amount of $12,000.00, on May 19, 1982.

24. On or about May 12, 1982, TNB purchased from GBSB, for $5,000.00, a participation in a certain loan in the amount of $5,000.00 made by GBSB to E. D. Steptoe on May 12, 1982.

25. On or about March 24, 1982, TNB purchased from GBSB, for $23,120.23, a participation in a certain loan in the amount of $41,000.00 made by GBSB to DeKalb Dairy, Inc. on September 19, 1981.

26. On or about June 15, 1982, TNB purchased from GBSB, for $30,000.00, a participation in a certain loan in the amount of $30,000.00 made by GBSB to

Dairyland Farms, Inc. on June 15, 1982.

27. On or about June 14, 1982, TNB purchased from GBSB, for $9,000.00, a participation in a certain loan in the amount of $9,000.00 made by GBSB to Dairyland Farms, Inc. on June 14, 1982.

28. On or about July 12, 1982, TNB purchased from GBSB, for $120,000.00, a participation in a certain loan in the amount of $121,000.00 made by GBSB to Freeman Nurseries, Inc. on July 1, 1982.

29. On or about June 30, 1982, TNB purchased from GBSB, for $100,000.00, a participation in a purported loan in the amount of $127,500.00, purportedly made by GBSB to Adam D. Bell, on June 26, 1982.

30. The loan of $127,500.00 purportedly made by GBSB to Adam D. Bell was never made by GBSB to Adam D. Bell.

31. The president of GBSB represented to TNB that a loan of $127,500.00 was made

by GBSB to Adam D. Bell and that the signatures on the loan documents, security agreements and supporting documents was the signature of Adam D. Bell.

32. The president of GBSB represented to TNB that he had personally inspected the purported collateral of Adam D. Bell.

33. These representations were misrepresentations of material facts and were made with the intention to induce TNB to purchase a participation in the Adam D. Bell loan.

34. TNB relied on these misrepresentations when it purchased the participation on the fraudulent Adam D. Bell loan, to its injury.

35. On or about June 30, 1982, TNB purchased from GBSB, for $100,000.00, a participation in a purported loan in the amount of $120,000.00, purportedly made by GBSB to Cecil H. Gunther, on June 4,

1982.

36. The loan of $120,000.00 purportedly made by GBSB to Cecil H. Gunther was never made by GBSB to Cecil H. Gunther.

37. The president of GBSB represented to TNB that GBSB had made a loan of $120,000.00 to Cecil H. Gunther and that the signature on the loan documents, security agreements, and supporting documents was the signature of Cecil H. Gunther.

38. The president of GBSB represented to TNB that an officer of GBSB had personally inspected the purported collateral of Cecil H. Gunther.

39. These representations were misrepresentations of material facts and were made with the intention to induce TNB to purchase a participation in the Cecil H. Gunther loan.

40. TNB relied on these misrepresentations when it purchased the

participation in the fraudulent Cecil H. Gunther loan, to its injury.

41. Of the remaining participations purchased by TNB referred to in Paragraphs 16 through 28 above, all underlying loans have been paid in full to FDIC. These funds are currently being held by FDIC in segregated trustee for owner accounts, for the benefit of TNB.

42. FDIC has failed and refused to pay TNB its proportional share of the loans referred to in Paragraphs 16 through 28 above.

43. On or about July 15, 1977, TNB purchased ten (10) capital debentures from GBSB in the aggregate amount of $100,000.00.

44. The capital debentures had a maturity date of July 15, 1984.

45. On or about August 2, 1982, two officers of TNB, Guy Dickert and Keith

Chambers, sought the advice of FDIC's field-liquidator-in-charge, James Duval, as to the proper procedure to be used in resolving the mutual obligations and transactions of TNB and GBSB.

46. James Duval was at all pertinent times an employee of FDIC and functioned as its field-liquidator-in-charge at GBSB, and was acting within the scope of his employment. As such, Mr. Duval was an agent of FDIc (sic).

47. At all pertinent times, Mr. Duval represented himself as having the authority to represent FDIC and its interests.

48. At all relevant times, James Duval represented to Guy Dickert and Keith Chambers that he did have the authority to bind FDIC and to authorize a set-off.

49. During the conversation of August 2, 1982 between Duval and TNB officers, James Duval recommended that TNB set off

the mutual obligations and transactions owing between GBSB and TNB.

50. When Guy Dickert acknowledged Mr. Duval's suggestion of exercising a set-off and informed Mr. Duval that TNB would exercise that right, Mr. Duval failed to protest or object to such set-off and acquiesced therein.

51. James Duval intended that his suggestion to exercise a set-off be acted upon.

52. By the acts of James Duval, FDIC gave its prior consent to the setoff of the obligations and transactions owing between TNB and GBSB.

53. TNB carried out an internal offset transaction of certain assets and liabilities of GBSB on August 3, 1982, effective July 27, 1982. Included among the GBSB assets subjected to the offset transaction were Certificates of Deposit T711017 and T711018, referred to

in Paragraph 7 above, and the three (3) loan participations GBSB had purchased from TNB, referred to in Paragraphs 8, 9 and 10 above. Included among the liabilities of GBSB subjected to the offset transaction were ten (10) subordinated capital debentures in the total face amount of $100,000.00, referred to in Paragraph 43, and the fifteen (15) loan participations TNB had purchased from GBSB, referred to in Paragraphs 16 through 29 and 35.

54. TNB acted and relied upon James Duval's recommendation, representations and apparent authority to bind FDIC when it instituted a set-off of all or part of the loan participation agreements, certificates of deposit and capital debentures referred to in Paragraph 54 above, to its injury. Such reliance was reasonable.

55. TNB detrimentally relied upon James

Duval's apparent authority to bind FDIC and authorize a set-off when TNB exercised its set-off, to its injury.

56. At no time between July 27, 1982, and May 5, 1983, did FDIC protest, object to or question TNB's set-off.

57. FDIC first objected to the set-off referred to in Paragraph 54 above by letter dated May 5, 1983. Such objection was untimely and constituted unreasonable delay on the part of FDIC.

58. In the set-off referred to in Paragraph 53 above, TNB set-off $655.81 of the principal on the Freeman Nurseries, Inc. loan participation referred to in paragraph 28 above. This set-off left a principal of $119,344.19 remaining on the Freeman Nurseries, Inc. loan participation. On November 15, 1982, FDIC paid TNB $126,591.09 as its portion of its participation in the Freeman Nurseries loan. This amount

represented the principal amount of $119,344.19 remaining after TNB had set-off a portion of the principal on July 27, 1982, plus accrued interest of $7,246.90.

59. All ATM fees which TNB seeks to recover in its Counterclaim was incurred by GBSB prior to its insolvency. This claim was absolute and certain in amount on July 28, 1982.

60. TNB filed a claim with FDIC, as receiver, for all ATM service fees incurred by GBSB through July 28, 1982, by letter dated October 29, 1982. These ATM services fees totaled $12,633.25 on October 29, 1982.

61. By letter dated May 10, 1983, FDIC recognized the validity of TNB's claim for ATM service fees incurred by GBSB. FDIC has never denied the claim filed by TNB for the ATM service fees.

62. FDIC has failed and refused, and

continues to fail and refuse, to pay TNB's claim for the ATM service fees.

63. On or about October 22, 1981, TNB purchased from GBSB for $20,000.00 a participation in a certain loan in the amount of $75,000.00 made by GBSB to TexArk Enterprises, Inc. ("TexArk") on May 19, 1981.

64. That certain loan made by GBSB to TexArk was secured by a deed of trust covering the following described property located in Bowie County, Texas, to-wit:

> Lot No. 2 and the North One-Half (N 1/2) of Lot No. 3 in Block No. 53 of the Original City of Texarkana, Bowie County, Texas.

65. On or abut (sic) March 1, 1983, the TexArk loan was in default and FDIC, in its corporate capacity, as successor-in-interest to GBSB, caused the property described in the deed of trust to be sold, and FDIC, in its corporate capacity, purchased that property for

$75,000.00 cash.

66. TNB's share of proceeds from the sale of the TexArk loan collateral was $20,000.00.

67. By letter dated April 20, 1983, TNB made timely demand on FDIC for its proportionate share of the proceeds from the sale of the collateral securing the TexArk loan.

68. FDIC tendered $5,400.00 to TNB as payment in full on the TexArk participation on September 7, 1984. TNB refused this payment under these terms.

69. FDIC has failed and refused, and continues to fail and refuse, to pay the $20,000.00 owing to TNB as its proportionate share of the proceeds of the sale of the collateral securing the TexArk Enterprises, Inc. loan.

## CONCLUSIONS OF LAW

I. The statements by the present (sic) of GBSB that the signatures of Adam D.

Bell and Cecil H. Gunther on their respective loan documents, security agreements and supporting documents, and that the president or another officer of GBSB had personally inspected the collateral were misrepresentations, were material and fraudulent, and were intended to and did induce the Defendant into purchasing participations in the respective fraudulent loans. The Defendant's reliance on such misrepresentations was justified. *Barclay's Bank D.C.O. v. Mercantile National Bank*, 481 F.2d 1224 (5th Cir. 1973). As a result, Defendant was entitled to a rescission of these participation agreements, based on fraud, prior to GBSB's insolvency. FDIC's liability on this claim was absolute and certain in amount when this suit was filed. *Interfirst Bank Abilene v. FDIC*, 777 F.2d 1092 (5th Cir. 1985).

II. Defendant's claim, or set-off, was made in a timely manner. TNB therefore had a provable claim against FDIC in the amount of its participations in the two fraudulent loans. Defendant's set-off of these participation agreements was therefore proper. *Interfirst Bank Abilene v. FDIC, supra.*

III. The remaining participation agreements were all entered into before July 28, 1982. Defendant's claim on the amounts owed under these participation agreements existed before GBSB's insolvency and does not depend on any new contractual obligation arising later. FDIC's liability on these claims was absolute and certain in amount when this suit was filed, since all of the underlying loans had been paid in full by the time this suit was filed. Defendant's claim, i.e., set-off, was made in a timely manner. Therefore,

Defendant's claims as to the remaining participation agreements were provable against the FDIC. Defendant's set-off of these participation agreements was therefore proper. *FDIC v. Liberty National Bank & Trust Co.*, 806 F. 2d 861 (10th Cir. 1986), *First Empire Bank v. FDIC*, 572 F. 2d 1361 (9th Cir. 1978).

IV. Defendant acquired the prior consent of FDIC before setting off GBSB's capital debentures. Its set-off of these capital debentures was therefore proper. 12 U. S. C. §1828(i)(1).

V. All of the participations owed TNB by GBSB were provable and due and owing on the date of the set-off. The capital debentures of GBSB were due and owing and the result of the insolvency of GBSB and the prior consent of FDIC. The participations owed GBSB by TNB were due and owing on the day of the set-off as a result of TNB exercising its right to

repurchase all or any part of the participations. The certificates of deposit were due and owing on the date of the set-off as a result of GBSB insolvency. *FDIC v. Liberty National Bank & Trust Co.*, 806 F.2d 961 (10th Cir. 1986). There was a mutuality of obligations between GBSB and TNB since all debts were owed in the same capacity. *FDIC v. Liberty National Bank & Trust Co., supra; Interfirst Bank Abilene v. FDIC, supra; First Empire Bank v. FDIC, supra.* TNB therefore had a right of set-off, and such set-off was valid and proper and not a preference in violation of 12 U.S.C. §94. *Scott v. Armstrong,* 146 U.S. 499 (1892); *Interfirst Bank Abilene v. FDIC, supra.*

VI. The set-off was exercised at the suggestion of James Duval, FDIC's field-liquidator-in-charge and agent. This suggestion by FDIC's agent, James

Duval, led Defendant to reasonably believe that a set-off would be proper. James Duval was willful with regard to his suggestion and his acquiescence in the acceptance by Defendant of his suggestion. These acts by Duval amount to affirmative misconduct on the part of FDIC. Defendant detrimentally relied on the propriety of its set-off as indicated by FDIC's agent, James Duval, to its injury. Under these facts, FDIC is held accountable for the representations of its agent, James Duval, and is estopped from asserting the impropriety of Defendant's set-off. *FDIC v. Harrison,* 735 F.2d 408 (11th Cir. 1984).

VII. FDIC appointed James Duval its field-liquidator-in-charge at GBSB. James Duval's job included the authority to advise persons and institutions dealing with the insolvent bank as to

their rights and proper course of action. James Duval held himself out as having the authority to act on behalf of FDIC and to protect its interests and to approve a set-off. FDIC failed to exercise such ordinary care as to inform the public and those dealing with James Duval as to the limits of his authority. FDIC by failing to exercise such ordinary care clothed James Duval with indicia of authority, thus leading TNB, acting as a reasonably prudent person, to believe that James Duval had the authority he purported to exercise. FDIC is therefore bound by the actions of James Duval since he was clothed with the apparent authority to act on behalf of FDIC. *Ames v. Great Southern Bank*, 672 S.W.2d 447 (Tex. 1984); *Rourke v. Garza*, 535 S.W.2d 794 (Tex. 1975).

VIII. FDIC has retained the benefits of the set-off by retaining all of the

funds paid on the underlying loans represented by the participation agreement set off by TNB. FDIC recognized the validity of the set-off by paying Defendant only that amount represented by the principal remaining after set-off, plus accumulated interest of the Freeman Nurseries, Inc. participation. FDIC made no protest or objection to the set-off between July 27, 1982 and May 5, 1983. FDIC's protest to the set-off by letter dated May 5, 1983 was untimely and constituted an unreasonable delay on the part of FDIC. Thus, by its subsequent actions and inactions, and its retention of the benefits of the set-off after acquiring full knowledge of the facts surrounding the set-off, FDIC has ratified James Duval's actions and the set-off. *Land Title Company of Dallas v. F.M. Stigler, Inc.*, 609 S.W.2d 754 (Tex. 1980).

IX. The $35,000.00 paid by GBSB to TNB on or about November 4, 1981, was for the initial right to participate in the ATM system in 1981. GBSB participated in the ATM system from on or about November 4, 1981, through July 28, 1982. Therefore, GBSB received full consideration for its $35,000.00, and no part of said amount is refundable.

X. FDIC, in its corporate capacity, purchased all the assets of GBSB remaining after the Purchase and Assumption Agreement with First Bank & Trust of Redwater. FDIC, as receiver, therefore failed to leave sufficient assets in the receivership to pay the unassumed creditors' claims, including TNB's claims against FDIC. FDIC, in its corporate capacity, is therefore liable to TNB on its counterclaims. *Woodbridge Plaza v. Bank of Irvine*, 815 F.2d 538 (9th Cir. 1987); *First Empire Bank v.*

*FDIC, supra.*

XI. FDIC has admitted its liability for the ATM service fees, and has never rejected the claim of TNB. Therefore, the statute of limitations has not begun to run on the ATM fees. *Gossett v. Green,* 152 S.W.2d 733 (Tex. 1941). Further, FDIC's claim for a pro rata refund of the ATM initial participation fee is based on the ATM Agreement between GBSB and TNB. TNB's counterclaim for the ATM fees arises out of this same contract, and therefore is a compulsory counterclaim under Federal Rule of Civil Procedure 13(a). As such the institution of FDIC's suit tolls the running of the statute of limitations covering this compulsory counterclaim. *DeVito v. Hoffman,* 199 F.2d 468 (D.C. Cir. 1952).

XII. FDIC is liable to TNB for the unpaid ATM service fees incurred by GBSB

prior to June 28, 1982. TNB is therefore entitled to judgment against FDIC in the amount of $12,633.25 plus interest at the rate of 8% from October 29, 1982.

XIII. On March 1, 1983, FDIC in its corporate capacity purchased the property securing the TexArk Enterprises, Inc. loan, by substitute trustee's sale for $75,000.00 in cash, thereby satisfying the loan to that extent. Consequently, TNB is entitled to its proportionate share of $20,000.00 less any expenses incurred by FDIC in the course of the sale. FDIC has failed to show any expenses incurred as a result of this sale. TNB is therefore entitled to judgment against FDIC in the amount of $20,000.00 plus interest at the rate of 8% from March 1, 1983.

XIV. Plaintiff, FDIC, in its corporate capacity, is not entitled to recover on

any of its claims asserted and tried in this case.

SIGNED AND ENTERED this 8th day of February, 1988.

/S/
United States District Judge

APPENDIX B-2

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS
TEXARKANA DIVISION

FEDERAL DEPOSIT INSURANCE CORPORATION, in its corporate capacity,
Plaintiff

VS. NO. TX-86-122-CA

TEXARKANA NATIONAL BANK,
Defendant

JUDGMENT

THIS ACTION came on for trial before the Court, and the evidence and supporting briefs have been furnished the Court, and the Court having entered its findings of fact and conclusions of law,

IT IS ORDERED AND ADJUDGED that the Plaintiff take nothing in its causes of action against the Defendant.

IT IS FURTHER ORDERED AND ADJUDGED that the Defendant have judgment against the Plaintiff for the unpaid Automatic Teller Machine service fees incurred by

Guaranty Bond State Bank prior to June 28, 1982, in the amount of $12,633.25, plus interest at the rate of 8% from October 29, 1982 until date of judgment; and that Defendant have judgment against the Plaintiff for its proportionate share of the proceeds from the sale of the property securing the TexArk Enterprises, Inc. loan in the amount of $20,000.00, plus interest at the rate of 8% from March 1, 1983 until date of judgment; plus interest on the total amount of this judgment from the date of judgment until paid at the rate of 10% per annum; and that the costs of this action be taxed against the Plaintiff herein.

SIGNED this 8th day of February, 1988.

/S/
United States District Judge